

December 17, 2010

Ms. Elizabeth Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549

**Via email: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)**

**Re: File Number S7-33-10, Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Release No. 34-63237 (Nov. 3, 2010)**

Dear Ms. Murphy:

The undersigned associations and companies represent every sector of the economy, employing millions of workers worldwide. As such, we recognize that strong corporate governance and compliance programs are a fundamental building block for successful businesses and a growing economy.<sup>1</sup>

We welcome this opportunity to comment on the U.S. Securities and Exchange Commission's ("SEC" or "Commission") proposed rules implementing the whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").<sup>2</sup> While the Proposed Rules address some of the issues arising from the Dodd-Frank provisions, we still have very serious concerns on the impact these whistleblower requirements will have on critical aspects of sound governance of public companies and on those companies' responsibilities to act in the best interests of their shareholders.

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<sup>1</sup> White & Case LLP has provided assistance to the undersigned associations and companies in analyzing the Proposed Rules and preparing this comment letter.

<sup>2</sup> Proposed Rules for Implementing the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, Release No. 34-63237 (Nov. 3, 2010) *available at* <http://www.sec.gov/rules/proposed/2010/34-63237.pdf> ("Proposed Rules"); *see* Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes New Whistleblower Program Under Dodd-Frank Act, Press Release No. 2010-213 (Nov. 3, 2010) *available at* <http://www.sec.gov/news/press/2010/2010-213.htm>.

Accordingly, we believe that the Proposed Rules can be improved through the following modifications:

- **Exclude culpable individuals from award eligibility;**
- **Exclude individuals with legal, compliance, audit, ethics responsibilities, or those who have a professional privilege from award eligibility, subject to a narrow exception;**
- **Condition award eligibility on the use of an available internal reporting system;**
- **Establish a policy under which the SEC will share information it receives with entities that are the subject of a complaint and provide those entities with an opportunity to fully investigate the allegations before they are reviewed by the Commission;**
- **Extend the 90-day grace period provided for whistleblowers to report information to the SEC after reporting it internally to 180 days; and**
- **Clarify that good-faith employment actions taken by a corporation that is the subject of a complaint are not retaliatory if based on factors other than an individual's whistleblower status.**

Our specific concerns and proposals are discussed in full below.

## **I. Proposed Rules and Corporate Compliance Programs**

Dodd-Frank was signed into law by President Barack Obama on July 21, 2010. Section 922 (a) of Dodd-Frank amends existing laws regarding whistleblowers. Dodd-Frank defines whistleblowers as individuals who provide information to the SEC in a manner established by rule or regulation and authorizes the SEC to pay awards to qualifying whistleblowers. Following an open meeting of the Commissioners, the SEC issued the Proposed Rules on November 3, 2010 to implement the Dodd-Frank whistleblower provisions.

As Commissioner Elisse B. Walter stated at the open meeting announcing the Proposed Rules, it is “critical” to investors that “existing and effective company compliance and other internal processes for responding to violations of federal securities laws . . . remain robust” even as rules implementing the program are implemented.<sup>3</sup>

As the commentary accompanying the Proposed Rules recognizes, they were drafted with the aim of preserving the role of corporate compliance programs and ensuring their continued effective functioning.<sup>4</sup> We applaud the Commission’s recognition of the important role that internal corporate programs have in promoting compliance with securities and other laws, and submit that preserving that role should be a policy touchstone in formulating rules to implement the Dodd-Frank whistleblower provisions. As the Commission’s statements in the commentary recognize, corporate compliance programs have evolved to become critical components of sound corporate governance. These programs also are designed to meet incentives and policy prescriptions issued by the federal government itself regarding the elements of adequate corporate compliance procedures. Federal enforcement authorities, including the U.S. Sentencing Commission, the Department of Justice, the SEC, and others have long encouraged corporations to implement compliance programs by providing credit or leniency to corporations with effective internal compliance programs at the time charging decisions or penalty assessments are made concerning wrongdoing by corporate employees.<sup>5</sup> These policies recognize that compliance programs provide corporations a means to identify and address potential misconduct at an early stage, and aid enforcement efforts by providing law

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<sup>3</sup> Elisse B. Walter, Commissioner, U.S. Sec. & Exch. Comm’n, Implementation of 21F of the Exchange Act, “Whistleblower Incentives and Protection” (proposed rules and forms) (Nov. 3, 2010) *available at* <http://www.sec.gov/news/speech/2010/spch110310ebw-whistleblowers.htm>.

<sup>4</sup> *See, e.g.*, Proposed Rules, *supra* note 2, at 24 (“Compliance with the federal securities laws is promoted when companies implement effective legal, audit, compliance, and similar functions.”).

<sup>5</sup> *See, e.g.*, U.S. Sentencing Guidelines Manual § 8B2.1 (2010) (defining “effective compliance and ethics program”); *id.* §§ 8C2.5, 8D1.4 (describing sentencing credit in exchange for such programs); U.S. Department of Justice, U.S. Attorneys’ Manual § 9-28.300 (identifying factors for a prosecutor to consider in charging decisions, including “the existence and effectiveness of the corporation’s pre-existing compliance program”); Commission Statement on the Relationship of Cooperation to Agency Enforcement Decision, Exchange Act Release No. 44969 (Oct. 23, 2001) (describing factors considered by SEC personnel when making enforcement decisions, including the compliance procedures in place at a corporation, corporate culture towards misconduct within the organization, steps taken by the corporation to address misconduct after is uncovered, and remedial actions taken by the corporation to prevent future misconduct).

enforcement with high quality information regarding actionable misconduct.<sup>6</sup> By offering means to ameliorate the negative consequences of corporate misconduct, these policies have long offered corporations an opportunity and an incentive to demonstrate good corporate citizenship in addressing wrongdoing.<sup>7</sup>

Effective compliance programs rely heavily on internal reporting of potential violations of law and corporate policy to identify instances of non-compliance. These internal reporting mechanisms are cornerstones of effective compliance processes because they permit companies to discover instances of potential wrongdoing, to investigate the underlying facts, and to take remedial actions, including voluntary disclosures to relevant authorities, as the circumstances may warrant.

We are very concerned that certain aspects of the Proposed Rules may undermine the functioning of effective corporate compliance programs by relegating them to the sidelines in the process of identifying and remedying violations of securities laws. Linda Thomsen, former director of the SEC's enforcement division recently stated: "the underlying premise of the statute is that if you pay people a lot of money you are going to get higher quality tips. If tested, I think you would find it unfounded".<sup>8</sup> Even assuming an increase in the number and size of enforcement actions, a whistleblower program that does not account for and fully maintain the vitality of corporate integrity programs will not be a net positive development for the interests of shareholders and the investing public. Moreover, if the effectiveness of

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<sup>6</sup> See Lucinda Low et al., *The Uncertain Calculus of FCPA Voluntary Disclosures*, Paper for the March 2007 American Conference Institute FCPA Conference (March 2007) *available at* <http://www.abanet.org/intlaw/spring07/World%20Bank%20Anticorruption%20Programs/Low%20-%20The%20Uncertain%20Calculus%20of%20FCPA%20Voluntary%20Disclosures.pdf> (describing increase in voluntary disclosures made to both the SEC and the Department of Justice and providing examples of federal agencies receiving information as a result of internal investigations); *see also* Gary G. Grindler, Acting Deputy Attorney General, Remarks at the 2010 *Compliance Week* Conference (May 25, 2010) *available at* <http://www.justice.gov/dag/speeches/2010/dag-speech-100525.html> ("As I hope has been clear in my discussion of our enforcement efforts, there is a consistent theme of the importance of sharing information and partnering with the private sector in its anti-fraud efforts.").

<sup>7</sup> See, e.g., Lanny A. Breuer, Assistant Attorney General, Criminal Division, U.S. Dep't of Justice, Remarks at the 24th National Conference on the Foreign Corrupt Practices Act, (Nov. 16, 2010) *available at* <http://www.justice.gov/criminal/pr/speeches/2010/crm-speech-101116.html> ("Establishing a top-notch compliance program will not only help to prevent misconduct from occurring, but it will also improve your position with us in any eventual investigation.").

<sup>8</sup> See Edward Wyatt, *For Whistle-Blowers, Expanded Incentives*, N.Y. Times, Nov. 14, 2010, *available at* <http://www.nytimes.com/2010/11/15/business/15whistle.html>.

corporate compliance programs in identifying potential wrongdoing is undermined, their attendant benefits, such as promotion of a culture of compliance within corporations, as well as their value to enforcement efforts, will likewise be diminished.<sup>9</sup>

Further, notwithstanding the Commission's recognition of the importance of these programs, several aspects of the Proposed Rules appear to be formulated for companies with inadequate or ineffective compliance systems. We urge the Commission to avoid this approach, geared toward accounting for the "lowest common denominator" of compliance culture, and instead to formulate rules recognizing that most public companies operate robust compliance programs, in which they have made significant financial investments and which reflect a top-down commitment to conduct business operations in compliance with law and standards of ethical business practices. We make provisions in our recommendations for circumstances where companies do not have adequate compliance procedures and/or internal reporting systems. We urge that such exceptional circumstances be recognized as such and dealt with accordingly in the Proposed Rules, rather than orienting administration of the whistleblower program to the exceptional circumstances of companies with inadequate compliance systems.

We suggest modifications to the Proposed Rules to preserve the role of robust compliance programs, while also fulfilling the stated goal of the Proposed Rules to "maximize the submission of high-quality tips and to enhance the utility of the information reported to the Commission."<sup>10</sup> Our recommendations reflect several underlying principles:

- **First, corporate employees should not be rewarded if they engage in, perpetuate, or fail to take action to stop *internal wrongdoing*.** Individuals who participated in wrongdoing should be excluded from award eligibility.

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<sup>9</sup> See, e.g., Donald C. Langevoort, *Monitoring: the Behavioral Economics of Corporate Compliance with Law*, 2002 Colum. Bus. L. Rev. 71, 81-82 (2002); see also Corporate Compliance Comm., ABA Section of Bus. Law, *Corporate Compliance Survey*, 60 Bus. Law 1759, 1759 (2005) (noting that in order to "achieve compliance with applicable legal regulations and internal ethical standards," compliance programs aim both to "create an ethical corporate culture that educates and motivate the organization's employees" and also "deter and detect violations through risk assessment, monitoring, auditing, and appropriate discipline").

<sup>10</sup> Proposed Rules, *supra* note 2, at 5.

Accordingly, Proposed Rule 21F-2's definition of "whistleblower" should be revised to cover only individuals who report violations of the securities laws "by another person, and who did not participate in or facilitate the violations."

- **Second, corporate employees and others who have compliance responsibilities within corporations should not be rewarded if they take actions inconsistent with those obligations.**

Accordingly, Proposed Rule 21F-4(b)(4)'s exclusions from award eligibility for personnel with legal, audit, supervisory, or governance responsibilities for an entity, and for information gained through legal, compliance, audit, or similar functions should be revised to

(i) make clear that such individuals are ineligible, and such information does not give rise to eligibility, absent an applicable exception to the general exclusions; and

(ii) require that any exception to these exclusions be subject to an "up before out" requirement, such that a whistleblower would be required to inform a company's chief legal officer, chief compliance officer, and/or a member of its board of directors of the substance of an allegation and any alleged inadequacy in the company's compliance systems or in its response to such an allegation before reporting to the Commission.

- **Third, it should be the policy of the Commission, reflected in the rules implementing the whistleblower program, to ensure that corporations are informed of potential wrongdoing involving their employees or others acting on their behalf.** Corporations and their management and directors have a duty to address internal malfeasance and are dependent on internal reporting of such instances to meet that responsibility. Moreover, companies themselves are often best positioned to quickly and effectively investigate potential wrongdoing. Policies that deprive them of such information—from internal sources

or from information received by the Commission from whistleblowers—would likely have a widespread negative effect on legal and regulatory compliance by public companies. Such policies also could weaken companies' internal controls over financial reporting, which management must assess, and to which external auditors must attest. Thus, individuals with relevant information should be incentivized to utilize internal reporting mechanisms, rather than discouraged from doing so.

Accordingly, Proposed Rule 21F-8 should be revised to require individuals to utilize available internal reporting systems, following prescribed procedures, as a condition of award eligibility. Any exception to such a rule for inadequate reporting systems should be determined as a matter of the Commission's sole discretion based on objective criteria, rather than on a whistleblower's subjective beliefs or conclusions.

Relatedly, the SEC should adopt a policy, which could be set forth in a new rule 21F-16, providing that it will notify any affected company of a whistleblower's allegations, subject to limited exceptions in extraordinary circumstances, so that the company may take such further action based on those allegations as it deems appropriate. Such a policy should state that, provided a company receiving such information from the SEC responds appropriately with an investigation, appropriate corrective action, and reporting of substantiated violations of law, it will be given full credit under applicable SEC policies as if it had self-reported.

- **Fourth, the 90-day grace period provided for whistleblowers to report information to the SEC if they first report it through an internal reporting system should be extended.** Ninety days will in many circumstances be insufficient time for a corporation to investigate a report of potential wrongdoing fully. Extending this time period would permit investigation of the facts and analysis of those facts under

applicable legal principles, and thus benefit both corporations and the Commission.

To permit full investigation and consideration of reports of potential wrongdoing, the 90-day grace period in the Proposed Rules should be extended to 180 days.

- **Lastly, the whistleblower program should not be implemented in a way that inhibits companies from taking appropriate employment or other action against internal wrongdoers.** Modifying the Proposed Rules to exclude from the definition of “retaliation” good faith employment actions based on factors other than whistleblower status would help mitigate the risk.

To avoid uncertainty concerning Dodd-Frank’s anti-retaliation and whistleblower protection provisions, the implementing rules should make clear that personnel actions taken by a company for reasons other than an employee’s whistleblower status do not violate the anti-retaliation provisions of Section 21(h) of the Exchange Act. Such clarification could appropriately be made in a separate rule in addition to those in the Proposed Rules.

## II. Suggested Modifications to the Proposed Rules

### A. Rule 21F-2: Exclude Culpable Individuals from Award Eligibility.

Culpable individuals who participated in the conduct that is the subject of a whistleblower complaint and subsequent successful SEC enforcement action should not be eligible for any award. Proposed Rule 21F-15 provides that any amount imposed in enforcement actions for “liability . . . based substantially on conduct that the whistleblower directed, planned, or initiated” is excluded from the calculation of whether the \$1 million threshold is satisfied and the calculation of the amount of an award.<sup>11</sup> Culpable individuals who did not direct, plan or initiate misconduct,

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<sup>11</sup> Proposed Rules, *supra* note 2, at 149.



however, are not subject to the exclusion, even if they actively participated in the misconduct underlying the successful enforcement action. Moreover, even culpable individuals that directed, planned, or initiated the misconduct, may be eligible for an award for successful enforcement actions that are not based “substantially on conduct that the whistleblower directed, planned, or initiated.”<sup>12</sup>

The Proposed Rules should be modified to ensure that all culpable individuals, including those who did not substantially direct, plan, or initiate conduct on which liability is based, are not eligible for an award. To avoid encouraging misconduct, participation in any wrongdoing that results in a successful enforcement action by the SEC should result in the exclusion from award eligibility.<sup>13</sup> Such exclusion could be accomplished by defining a “whistleblower” in rule 21F-2, as one who reports violations of the securities laws, “*by another person*,” (as the Commission has suggested<sup>14</sup>) “*and who did not participate in or facilitate the violations.*”<sup>15</sup>

**B. Rule 21F-4 and Form TCR: Clarify Exclusions for Information Obtained by a Person with Legal, Compliance, or Similar Responsibilities, and for Information Otherwise Obtained From or Through an Entity’s Legal, Compliance, or Similar Functions.**

The Proposed Rules contain, in Rule 21F-4(b)’s definition of “original information,” several important exclusions from award eligibility based on the manner

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<sup>12</sup> *Id.*

<sup>13</sup> Of course, a wrongdoer’s decision to come forward voluntarily will still remain a positive factor that prosecutors, enforcement agencies and judges may take into account in assessing the appropriate enforcement action and/or penalties for the wrongdoer’s conduct. See, e.g., 17 C.F.R. § 202.12 (2010) (SEC policy statement concerning cooperation by individuals in investigations); U.S. Dep’t of Justice, U.S. Attorneys’ Manual § 9-27.230 (consideration of cooperation in initiating and declining charges); U.S. Sentencing Guidelines Manual §5K2.16 (2010) (consideration of voluntary disclosure of offense in sentence calculation).

<sup>14</sup> In Request for Comment 1, the Commission states: “In other provisions of these Proposed Rules – e.g., Proposed Rule 21F-15 – we propose that whistleblower not be paid awards based on monetary sanctions arising from their own misconduct, based on the notion that the statute is not intended to reward persons for blowing the whistle on their own misconduct. Consistent with this approach, should we define the term ‘whistleblower’ to expressly state that it is an individual who provides information about potential violations of the securities laws ‘by another person’?” Proposed Rules, *supra* note 2, at 8.

<sup>15</sup> Under the modified Rules as suggested herein, Proposed Rule 21F-15 regarding the calculation of awards for culpable individuals, would no longer be necessary in light of the complete exclusion of culpable individuals from award eligibility set forth in modified Rule 21F-2. The modified Rules set forth in the Appendix to this letter therefore do not contain Proposed Rule 21F-15 and have been renumbered accordingly.

in which an individual obtained the information submitted. Two of the exclusions relate specifically to existing compliance programs, one addressing company personnel with legal, compliance, or similar responsibilities, and the other addressing information obtained through a company's legal, compliance, audit, or supervisory functions.<sup>16</sup> Neither exclusion applies, however, where a corporation acts in "bad faith" or does not report information it receives to the SEC within a "reasonable time."<sup>17</sup> While the goal of these provisions is an important one, the exclusions and related carve-outs present potential problems of application that should be addressed in the rules.

In this regard, the Proposed Rules contain the following request for comment:

*Do the proposed exclusions for information obtained by a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity under an expectation that the person would cause the entity to take steps to respond to the violation, and for information otherwise obtained from or through an entity's legal, compliance, audit, or similar functions strike the proper balance? Will the carve-out for situations where the entity does not disclose the information within a reasonable time promote effective self-policing functions and compliance with the law without undermining the operation of Section 21F? Should a "reasonable time" be defined in the rule and, if so, what period should be specified (e.g., three months, six months, one year)? Does this provide sufficient incentives for people to continue to utilize internal compliance processes? Are there alternative or additional provisions the Commission should consider that would promote effective self-policing and self-reporting while still being consistent with the goals and text of Section 21F?<sup>18</sup>*

The commentary to the Proposed Rules further indicates that these exclusions are specifically intended to avoid "creating incentives for company personnel to seek a

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<sup>16</sup> Proposed Rule 21F-4(b) (4) (iv) provides that an individual cannot qualify for an award if the information was received "because" the individual was a person with "legal, compliance, audit, supervisory, or governance responsibilities . . . and the information was communicated to [the individual] with the reasonable expectation that [the individual] would take steps to cause the entity to respond appropriately." Proposed Rule 21F-4(b) (4) (v) states that information obtained "[o]therwise from or through an entity's legal, compliance, audit, or similar functions or processes for identifying, reporting and addressing potential non-compliance with the law" will not qualify any individual for an award. Proposed Rules, *supra* note 2, at 129-130.

<sup>17</sup> *Id.* at 129-130.

<sup>18</sup> *Id.* at 30.

personal financial benefit by ‘front running’ internal investigations and similar processes that are important components of effective company compliance programs.”<sup>19</sup>

These exclusions are important if corporate compliance programs are to continue to operate effectively. If personnel charged with responding to internal reports of wrongdoing were in a position to benefit financially from disclosing such information to the SEC, corporate compliance functions could soon grind to a halt. The very people charged with orchestrating a company’s response could choose financial self-interest over corporate responsibility. These persons also would have a personal incentive to maximize any eventual fine or other penalty paid by the company. For this reason, the exclusion from eligibility for persons who have compliance or similar responsibility within a company, or who learn information through a compliance or similar function, needs to be carefully drawn, strongly enforced, and any exceptions limited as much as possible consistent with the parameters of the enabling statute.

Several modifications to the Proposed Rules and accompanying forms are needed. First, to enable the Commission to determine whether whistleblowers submitting information fall into excluded categories, Form TCR, on which a whistleblower is required to describe his or her allegations, should be amended to request that information. Specifically, a new Question 3a should be added, as follows:

*3a. Are you a person with legal, compliance, audit, supervisory, or governance responsibilities for the entity about which you are providing information?*

Second, to permit the Commission to determine whether a whistleblower learned the information reported from or through an entity’s compliance function, the instructions for completing Form TCR should be modified to include the following for responding to Question 8:

*In particular, describe whether you learned any of the information you are reporting through any system or procedure maintained by the entity for reporting of potential violations of law, including the compliance office, internal hotline, or ombudsman or*

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<sup>19</sup> *Id.* at 26.

*from any person or source, directly or indirectly, with responsibility in or for such system or procedure.*

Without requiring this information from a whistleblower, application of Proposed Rule 21F-4(b) in the manner intended by the Commission would be extremely difficult.

Further, to provide guidance to potential whistleblowers who may be covered by the applicable exclusions, the rules should provide that any individual who has a legal, compliance, or similar function in a company will be ineligible for a whistleblower award unless he or she has first reported the information in question to an entity's chief legal officer, chief compliance officer, and/or a member of the Board of Directors.

Finally, the Commission should modify the Proposed Rules to avoid the suggestion—reflected in the Proposed Rules as currently drafted—that it should be the company's obligation to disclose all information it receives about any potential SEC violation. Such a requirement would not only place an unrealistic responsibility on companies, but it would also unduly burden the SEC, which would find itself inundated with and having to review and process a high volume of poor quality tips and frivolous or otherwise meritless allegations. This does not appear to have been the Commission's intent in promulgating the Proposed Rules, since the Commentary elsewhere clearly recognizes the need to “provide a mechanism by which some of those erroneous cases may be eliminated before reaching the Commission, without otherwise adversely affecting the incentives on the part of potential whistleblowers.”<sup>20</sup> Requiring companies to disclose within a reasonable time only information concerning substantiated securities laws violations would better reflect the Commission's objectives and would substantially reduce the burden on SEC resources.

These objectives could be effectuated through the following modifications to Proposed Rule 21F-4(b) (4) (iv) and (v):

(iv) Because you were a person with legal, compliance, audit, supervisory, or governance responsibilities for an entity, and the information was

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<sup>20</sup> *Id.* at 113.

communicated to you with the reasonable expectation that you would take steps to cause the entity to respond appropriately to the violation, unless *you disclosed the information to the chief legal officer, chief compliance officer, and/ or a member of the Board of Directors and* the entity proceeded in bad faith or failed to disclose information *concerning substantiated violations of the securities laws* to the Commission within a reasonable time; or

(v) Otherwise from or through an entity's legal, compliance, audit or other similar functions or processes for identifying, reporting and addressing potential non-compliance with law, unless *you disclosed the information to the chief legal officer, chief compliance officer, and/ or a member of the Board of Directors and* the entity proceeded in bad faith or failed to disclose information *concerning substantiated violations of the securities laws* to the Commission within a reasonable time.

Such provisions would ensure that, before a corporation could be deemed to have acted in bad faith or failed to disclose required information to the SEC in a reasonable time, a senior officer or director of the company had been made aware of the allegation and afforded an opportunity to direct the company to respond appropriately.

**C. Rule 21F-8 and Form TCR: Require Whistleblowers to Utilize Available Internal Reporting Systems as a Condition of Award Eligibility.**

The Proposed Rules contain the following request for comment:

*Should the Commission consider a rule that, in some fashion, would require whistleblowers to utilize employer-sponsored complaint and reporting procedures? What would be the appropriate contours of such a rule, and how could it be implemented without undermining the purposes of Section 21F?<sup>21</sup>*

We submit that such a rule must be implemented if corporate compliance programs are to remain effective after the implementation of these Rules.

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<sup>21</sup> *Id.* at 36-37.

Many corporate compliance programs and/or employee codes of conduct impose an obligation on all employees to report conduct that violates law or corporate policy, including violations of the securities laws, via internal channels. The possibility of a whistleblower award, however, provides a potentially overwhelming monetary incentive for whistleblowers to ensure that any report they make to the SEC is credited as “original information” under Proposed Rule 21F-4(b), and to avoid any action that might threaten that status.<sup>22</sup> Because the Proposed Rules do not require that a whistleblower demonstrate that he or she has used an available internal reporting system to be eligible for an award, they would inevitably lead whistleblowers to bypass internal reporting systems. This will unavoidably undermine the effective functioning of corporate compliance programs, including by depriving corporations of information they need to investigate and address misconduct quickly and effectively.

To avoid such problematic consequences, Proposed Rule 21F-8, addressing whistleblowers’ eligibility for awards, should be modified to provide that a whistleblower who does not, prior to the submission of information to the Commission, report information relating to a potential violation of the securities laws through an available internal reporting system, is ineligible for an award unless the company in question lacked an internal reporting mechanism.

The following modifications to Proposed Rule 21F-8(c) and Form TCR would implement this change. First, the following new subsection (1) could be added to Proposed Rule 21F-8(c):

(c) You are not eligible to be considered for an award if you do not satisfy the requirements of paragraphs (a) and (b) of this section. In addition, you are not eligible if:

*(1) You do not report the information relating to a potential violation of securities laws through an available internal reporting system following applicable internal procedures prior to your submission of information to the Commission. Use of an available internal reporting system is not required,*

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<sup>22</sup> For example, if there is no penalty for failing to report internally, a potential whistleblower who perceives even a slight risk that an internal report could be mischaracterized by his employer, which would later be required to certify the date and content of the report, may decide, so as not to jeopardize his eligibility for an award, that he should not report internally.

*however, if the Commission, in its sole discretion based on the information required to be submitted in Form TCR, Question 4d, determines that the entity offered no practical method of reporting violations or no procedures to safeguard anonymity of reports.*

Second, to permit the Commission to assess whistleblowers' eligibility for awards under this standard, Form TCR could be modified to add a new Question 4d, requiring the whistleblower to provide the following information:

- (i) Does the entity that is the subject of the information you are providing have an internal hotline for reporting misconduct?*
- (ii) Does the entity's internal reporting system permit anonymous reporting?*
- (iii) Does the entity's code of conduct or other policy prohibit retaliation for reporting potential misconduct?*
- (iv) Did you report the alleged misconduct internally, using existing reporting procedures? If not, why? If you did report the alleged misconduct internally, what if any response did you receive and/or what if any action did the entity take, to your knowledge?*

Conditioning an award on appropriate utilization of internal reporting processes would provide a strong incentive for whistleblowers to report internally, which would enable companies to continue to receive essential information about potential misconduct necessary to maintaining robust corporate compliance programs. Such a requirement is well within the discretion afforded to the Commission by Dodd-Frank in implementing the new whistleblower program,<sup>23</sup> and, with an appropriate grace period for a whistleblower to alert the SEC after reporting internally and awaiting internal action,<sup>24</sup> internal disclosure would not prevent any individual from

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<sup>23</sup> Dodd-Frank defines a "whistleblower" as an individual who provides information to the SEC "in a manner established, by rule or regulation, by the Commission." Securities Exchange Act of 1934, § 21F (a) (6) *amended by* Dodd-Frank, Pub. L. No. 111-203, § 922(a) (2010). Dodd-Frank authorizes the SEC to pay awards to qualifying whistleblowers "under regulations prescribed by the Commission." Securities Exchange Act of 1934, § 21F (b) (1) *amended by* Dodd-Frank, Pub. L. No. 111-203, § 922(a) (2010). Finally, the legislative history of Dodd-Frank indicates that the SEC is granted broad discretion to determine whether an individual is eligible for an award. *See* S. Rep. No. 111-176, at 112 (2010) (Conf. Rep.) ("The SEC has discretion in determining the amount and whether or not a whistleblower is eligible to be awarded.").

<sup>24</sup> *See* Part II (E), *infra*.

establishing eligibility for an award. Finally, an internal reporting requirement would assist in filtering out low-quality or non-securities related tips and obviate the need to deploy SEC resources on such matters.

**D. New Rule 21F-16: Establish SEC Policy on Information Sharing with Corporations.**

Many corporate compliance programs and/or employee codes of conduct impose an obligation on all employees to report conduct that violates law or corporate policy, including violations of the securities laws, via internal channels. The commentary accompanying the Proposed Rules indicates that the SEC considered but rejected the possibility of requiring that an individual first report through such “in-house complaint and reporting procedures, thereby giving employers an opportunity to address misconduct, before they make a whistleblower submission to the Commission.”<sup>25</sup> The SEC indicates that “among [its] concerns” with this approach was that “while many employers have compliance processes that are well-documented, thorough, and robust, and offer whistleblowers appropriate assurances of confidentiality, others lack such established procedures and protections.”<sup>26</sup> We respectfully submit that the exceptional circumstances of companies with inadequate compliance programs should not be the touchstone of enforcement policy in the proposed rules.<sup>27</sup>

Rather, the Proposed Rules should provide that the SEC will inform any company that is the subject of a whistleblower report and furnish such details concerning the report so as to provide the company an opportunity to investigate, absent an objective basis to conclude that the company will not respond in good faith. This formulation would preserve the Commission’s discretion to make exceptions from a policy of prompt notification to affected companies where there are objective and articulable grounds for such an exception, namely, an objective basis for concluding that the company will not respond in good faith. The Commission, however, rather than adopting a policy grounded in the belief that exceptional

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<sup>25</sup> Proposed Rules, *supra* note 2, at 34.

<sup>26</sup> *Id.*

<sup>27</sup> For example, federal securities laws already require that public issuers maintain confidential reporting mechanisms and documented procedures to address tips regarding accounting and auditing matters. 15 U.S.C. § 78j-1(m) (4) (2006).



circumstances exist with respect to some companies, should accept the burden of identifying those exceptional circumstances, by determining that an entity offered no practical method of reporting violations or no procedures to safeguard anonymity of reports.

An appropriate modification could be accomplished by the addition of a new rule 21F-16 to the Proposed Rules, as follows:

*After receipt of a whistleblower report, the Commission will promptly provide an entity that is the subject of such a report with sufficient information about the allegations contained in the report to permit the entity to conduct an investigation into the allegations, absent a determination by the Commission, based on the information submitted in Form TCR, Question 4d, that the corporation will not proceed in good faith upon receiving the information. The Commission will allow the entity a reasonable time, but not less than 180 days unless the Commission determines otherwise for good cause, to perform all tasks necessary for an adequate investigation of the allegations, including but not limited to, interviews of relevant individuals, collection and review of documents and other relevant information, and an analysis of the relevant information with the assistance of internal or external counsel. In providing information to an entity that is the subject of a whistleblower report, the Commission will protect the anonymity of those individuals that utilize the procedures for anonymous submission of information to the Commission. Where an entity responds in good faith to such information from the Commission, which may include conducting an investigation, reporting the results of such an investigation to the Commission, and taking appropriate corrective action, the entity will receive credit as if it had self-reported the information, and its actions in response to such information will be evaluated, in accordance with the Commission's Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions.*

Articulating such a policy of information sharing would both enhance corporate compliance efforts and improve the efficiency of enforcement efforts. By affirming the importance of internal corporate information gathering and reporting processes, the Commission would allow those processes to remain viable and effective. This in turn would enable corporations not only to continue identifying potential misconduct and addressing wrongdoing but also to continue providing valuable assistance to the SEC in the form of vetted and validated information. Specifically, the SEC would be

able to rely on corporate investigatory efforts as the first line of defense against wrongdoing. Internal investigations conducted by corporations would help the agency effectively handle low-quality tips and serve as a screening mechanism to help ensure that the SEC devotes the bulk of its resources to investigating high-quality tips, as envisioned by the Proposed Rules.

**E. Rule 21F-4(b) (7): Provide Corporations with a Reasonable Time for Internal Investigations.**

Relatedly, and as the Commission has aptly recognized in the Proposed Rules, there are mutual benefits to the SEC as well as to the continued viability of corporate compliance programs in including a “grace period” for “a potential whistleblower to provide information to legal or compliance personnel within his or her company ... without compromising his or her eligibility for an award under the Program.”<sup>28</sup> After seeking redress internally and allowing time for internal review, the whistleblower could still report the alleged wrongdoing to the SEC within the “grace period,” without jeopardizing his or her eligibility for an award. As the Commentary to the Proposed Rules recognizes, providing such a “grace period” will not only reaffirm the importance of internal corporate processes to investigate and address wrongdoing, but, by filtering out poor quality tips and information through internal corporate validation processes, it will also enable the SEC to better allocate its resources to focus on high quality information regarding potential misconduct.<sup>29</sup>

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<sup>28</sup> Proposed Rules, *supra* note 2, at 112.

<sup>29</sup> As the Commentary to the Proposed Rules explains:

One economic benefit of providing this grace period is that the individual could be mistaken about securities laws, and the compliance personnel would likely be better informed about whether certain conduct constitutes a violation of securities laws. Without this grace period, individuals, regardless of whether their judgments regarding certain violations were correct, could be motivated to report a suspicious finding as soon as possible. The overall effect could be an overflow of noisy signals—that is, a large number of tips of varying quality—causing the Commission to incur costs to process and validate the information. Allowing for this proposed grace period, we believe, provides a mechanism by which some of those erroneous cases may be eliminated before reaching the Commission, without otherwise adversely affecting the incentives on the part of potential whistleblowers.

*See id.* at 112-113.

In Proposed Rule 21F-4(b) (7), the Commission has suggested a 90-day grace period, but has requested comment regarding whether this is the appropriate period.<sup>30</sup> We submit that the grace period should be changed to 180 days, to better reflect the reality of internal investigations and preserve as “voluntary” the decision of a corporation to disclose the results of an investigation to the Commission or other authorities.

Ninety days will in many circumstances be insufficient time for a corporation to fully investigate a report of potential wrongdoing and determine whether it has merit. The relevant facts must be collected and analyzed in order to reach an informed conclusion about the merits of the complaint. At a minimum, this will often require interviews of relevant individuals and the collection and review of relevant documents. In more complicated cases, an entity may have to engage forensic or accounting experts to determine the import of the collected facts. After the facts are established, an analysis of those facts and the legal implications presented must be performed, which typically involves internal or external counsel, or both. Finally, depending upon the allegations in a complaint, senior management or members of the board may have to be consulted on the appropriate course of action for the company. The amount of time required to perform an investigation will naturally vary depending upon the allegations in a complaint, but unless the complaint and the factual and legal issues raised are quite simple and straightforward, 90 days will rarely be sufficient for a corporation to complete the often time-consuming and resource-intensive steps required to reach an informed decision.

The Proposed Rules’ 90-day window would in effect require self-reporting to the SEC by a corporation, regardless of whether its investigation is complete and regardless of whether it has reached a determination concerning the merits of the allegation. The benefit of permitting a corporation’s internal compliance processes to assess a report of misconduct in the first instance, and of avoiding an incentive to “front-run” such investigations, thus would be undercut by this relatively short time frame. Allowing corporations to more fully investigate internal reports and weed out frivolous complaints would permit more informed corporate decisions about disclosure of the results of internal investigations, and would also reduce the burden

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<sup>30</sup> *Id.* at 36 (“Is the 90-day deadline for submitting Forms TCR and WB-DEC to the Commission (after initially providing information about violations or potential violations to another authority or the employer’s legal, compliance, or audit personnel) the appropriate timeframe?”).

on the SEC by sparing the Commission from processing and filtering a large volume of poor quality submissions. This in turn would further the Commission's goal of increasing high-quality tips without being flooded by frivolous tips or tips unrelated to securities law violations.

These objectives can be accomplished by changing the 90-day window to a longer 180-day window for whistleblowers to report to the SEC complaints that they have reported internally.

**F. New Rule 21F-17: Provide Guidance on Anti-Retaliation Provisions of Dodd-Frank.**

Dodd-Frank provides that:

[n]o employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower—

- (i) in providing information to the Commission in accordance with this section;
- (ii) in initiating, testifying in, or assisting any investigation or judicial or administrative action of the Commission based upon or related to such information; or
- (iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002.<sup>31</sup>

The law creates a private cause of action as a means to enforce these anti-retaliation provisions.

The Proposed Rules do not specifically address adverse actions against whistleblowers or the anti-retaliation provisions of Dodd-Frank, beyond making clear that “provisions of Section 21F of the Exchange Act do not provide amnesty to

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<sup>31</sup> Securities Exchange Act of 1934, § 21F (h) (1) (A) *amended by* Dodd Frank, Pub. L. No. 111-203, § 922(a) (2010).

individuals who provide information to the Commission relating to a violation of the securities laws.”<sup>32</sup> The Proposed Rules do not expressly address a company’s ability to take legitimate employment action to redress misconduct committed by whistleblower employees. Moreover, because “whistleblower” is broadly defined to include any individual who provides information to the SEC concerning a potential violation of the securities laws, and because the anti-retaliation provisions of Dodd-Frank are deemed to apply to any whistleblower, the risk of litigation in which “retaliation” is alleged is significant.<sup>33</sup>

The Commission has requested comment on whether it should implement modifications to clarify the Proposed Rules.<sup>34</sup> We submit that modifications are essential to prevent companies from being barraged with meritless lawsuits cloaked in the mantle of “retaliation” claims. Otherwise, because the Proposed Rules provide little guidance regarding the anti-retaliation provisions or the parameters of conduct that may potentially subject an employer to retaliation claims under Dodd-Frank, employers will not be able to effectively address violations of law or of company policy by employees without risking allegations of retaliation in litigation.<sup>35</sup> While, as a matter of law, employers should be free under the provisions of Dodd-Frank to take adverse employment action against employees for non-retaliatory reasons—e.g., involvement in culpable conduct—even where such employees have provided information to the SEC, as a practical matter, absent clarifying rules reaffirming this legal principle, the broad anti-retaliation provisions of the statute will prompt a wave of litigation alleging retaliation even in such circumstances. Companies will then be

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<sup>32</sup> Proposed Rules, *supra* note 2, at 82.

<sup>33</sup> *See id.* at 124-125.

<sup>34</sup> *See id.* at 89-90 (“Are there rule proposals that the Commission should consider promulgating to ensure that the anti-retaliation provisions are not used to protect employees from otherwise appropriate employment actions (i.e., employment actions that are not based on reporting potential securities law violations)?”).

<sup>35</sup> *See generally* Mary L. Schapiro, Chairman, U.S. Sec. & Exch. Comm’n, Testimony on Implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (September 30, 2010) *available at* <http://www.sec.gov/news/testimony/2010/ts093010mls.htm> (noting that the SEC has already experience an “uptick” in the number of whistleblower complaints after the enactment of Dodd-Frank); Melissa Klein Aguilar, *More Whistleblower Reforms in Dodd-Frank Act*, Compliance Week, August 17, 2010 *available at* <http://www.complianceweek.com/index.cfm?fuseaction=article.viewArticle&articleId=6114&&msg=> (describing Dodd-Frank’s expansion of whistleblower protection and noting that it may well lead to an increase in retaliation lawsuits).

forced to devote significant resources to defending against the onslaught of meritless litigation, at the expense of jobs and innovation.

Accordingly, we urge the Commission to make clear in the Rules that the anti-retaliation provisions of Dodd-Frank do not apply to employment actions based on factors other than whistleblower status. In particular, the Proposed Rules should address what may be relatively common issues under the whistleblower program—whether an employer may take employment action against an employee for involvement in wrongdoing reported to the Commission, for involvement in any other wrongdoing in violation of the company’s code of conduct and policies, or for failure to report information concerning potential wrongdoing internally as required by a code of conduct. Under the anti-retaliation provisions of Dodd-Frank, such action is permissible, and the rules should make explicit this common sense principle, so as to forestall costly (even if ultimately unsuccessful) employment litigation.

The clarification could be accomplished by the addition of a new rule 21F-17, reading as follows:

*§ 240.21F-17 Anti-Retaliation Provisions of Whistleblower Program*

*The protections against retaliation provided to whistleblowers by Section 21F(h) of the Exchange Act shall not affect the ability of employers to take non-retaliatory action against employees. The anti-retaliation provisions of Section 21F(h) do not apply if an employment action is taken for any reason other than an individual’s status as a whistleblower under these Rules. For example, adverse action taken because of an employee’s involvement in wrongdoing does not constitute retaliation, irrespective of whether the employee reported that wrongdoing to the Commission. Likewise, if an employer’s code of conduct requires the use of an available internal reporting system in the event that an employee becomes aware of potential misconduct, requires truthful cooperation with any investigation of potential misconduct, or prohibits the theft or misuse of company property or information, adverse action against an employee for failure to adhere to such requirements does not constitute retaliation, regardless of whether the individual provided information to the Commission.*

In addition to avoiding a significant economic burden, this modification to the Proposed Rules would be fully consistent with longstanding policies of the SEC, as well as the Department of Justice, the Sentencing Commission and

other federal enforcement agencies, which have repeatedly underscored that a key element of an effective corporate compliance program is the company's demonstrated practice of imposing discipline and corrective actions to address compliance violations.<sup>36</sup> Clarifying the Proposed Rules as suggested would enable companies to continue to meet this critical element of an effective compliance program. Without the clarification, the continued viability of internal disciplinary compliance processes is jeopardized, which would be contrary to longstanding federal government policy.

### **III. Conclusion**

We recognize that no individual or company is perfect and that mistakes are made. As a part of that recognition, many companies have spent millions of dollars and employ dedicated teams of employees, often going beyond what the law requires, to construct robust compliance programs that identify and correct mistakes, and inform government entities of wrongdoing identified and corrective action taken, when appropriate. The Proposed Rules have the potential to incentivize employees and others to act in ways that could undermine corporate compliance programs and related systems such as financial reporting safeguards. Simply put, if those systems are endangered or degraded, the ability of public companies in the United States to police their own conduct will be diminished, as will their ability to provide valuable information and assistance to enforcement efforts, and the culture of compliance that so many have worked hard to build will be significantly weakened.

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<sup>36</sup> In order to qualify as an "effective compliance and ethics program" under the federal Sentencing Guidelines, "[t]he organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent and detect criminal conduct." U.S. Sentencing Guidelines Manual § 8B2.1 (b) (6) (2010). In describing how to evaluate a corporation's compliance program, section 9.28-800 of the U.S. Attorneys' Manual instructs federal prosecutors to consider, among other factors, "any remedial actions taken by the corporation, including, for example, disciplinary action against past violators uncovered by the prior compliance program and revisions to corporate compliance programs in light of lessons learned." U.S. Dep't of Justice, U.S. Attorneys' Manual § 9.28-800. Finally, the Seaboard Report lists thirteen different criteria that the SEC will consider when determining whether, and how much, to credit a corporation for its cooperation efforts. Among other criteria, the agency will consider: "What steps did the company take upon learning of the misconduct? Did the company immediately stop the misconduct? Are persons responsible for the misconduct still with the company? If so, are they still in the same positions?" U.S. Sec. & Exch. Comm'n, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement, Exchange Act Release No. 44969 (Oct. 23, 2001).

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Our proposals seek to achieve the goals of ensuring the Commission receives quality tips while at the same time preserving the important functions of corporate compliance programs. The undersigned stand ready to work with the Commission to achieve a fair and rational implementation of Dodd-Frank's whistleblower provisions. Thank you for your consideration of our comments.

Sincerely,

Allstate Insurance Company

American Institute of Certified Public Accountants

American Insurance Association

Americans for Limited Government

Association of Corporate Counsel

AT&T

Center for Business Ethics, Bentley University

Dover Corporation

FedEx Corporation

Financial Services Institute, Inc.

Pharmaceutical Research and Manufacturers of America

Retail Industry Leaders Association

Royal Caribbean Cruises Ltd.

Ryder System, Inc.

UPS

U.S. Chamber of Commerce



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U.S. Chamber Institute for Legal Reform

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White & Case LLP

CC: The Honorable Mary L. Schapiro, Chairman  
The Honorable Kathleen L. Casey, Commissioner  
The Honorable Elisse B. Walter, Commissioner  
The Honorable Luis A. Aguilar, Commissioner  
The Honorable Troy A. Paredes, Commissioner  
Mr. Robert S. Khuzami, Director, Division of Enforcement